RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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January 10, 2001 **LETTER 1312**

WHY I'M STILL WRITING: On a recent site posting I mentioned books by the great stock market masters -- Dow, Hamilton, Rhea, Schaefer, Schabacker, Drew, Hughes, etc. A few subscribers asked for the exact titles of these books. Almost all of them are out of print and can only be found via a book search. Jimmy Hughes, who worked for the old Auchincloss, Parker, Redpath firm, never wrote a book. I just collected his original writings on the advance-decline ratio and bound them in book form.

So yes, I realize how difficult it is to find these books. Before I went into the letter-writing business, I spent many years studying the works of the stock market masters. The great Dow Theorist, George Schaefer, who died in 1974, was my mentor. Robert Rhea died back in 1939, and his writings changed my life. I can hardly expect my subscribers to have the same experiences that I had. Those days are gone. The masters are long gone, and their books are difficult to find.

However, in my writing over any period of a year or two, I hope to impart a lot of what I've learned to my subscribers. Happily I have two ways of communicating -- *Dow Theory Letters* and the daily Internet site . The best way to learn a subject, and this certainly includes the stock market, is through actual experience, through living it. As the market progresses, we observe, we study, we learn.

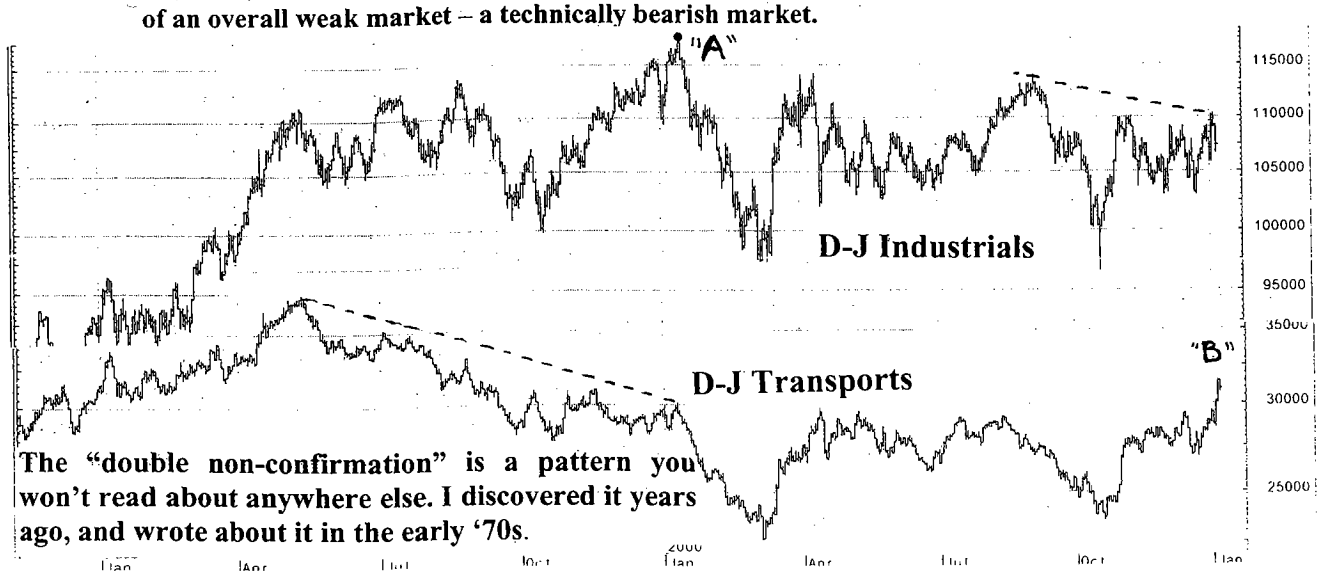
December 22, DJIA 10635.60; PTI 5193; A-D Ratio –6.76
December 29, DJIA 10787.98; PTI 5197; A-D Ratio –5.87
January 5, DJIA 10648.59; PTI 5195; A-D Ratio –5.59
***Dow Times Book Value: +6.51**
***Percentage of Undervalued Blue-chips: 14%**
***Gold 34-day MA: 272.3 Dow yield: 1.64; Dow p/e: 18.9**
correction for Dec. 15: Dow yield: 1.73; Dow p/e: 19.8

We better learn, because the market is an unforgiving teacher. If we have any weakness – cowardice, arrogance, selfishness, greed, laziness, forgetfulness – the market will zero in on that failing, and make us pay dearly for our defects.

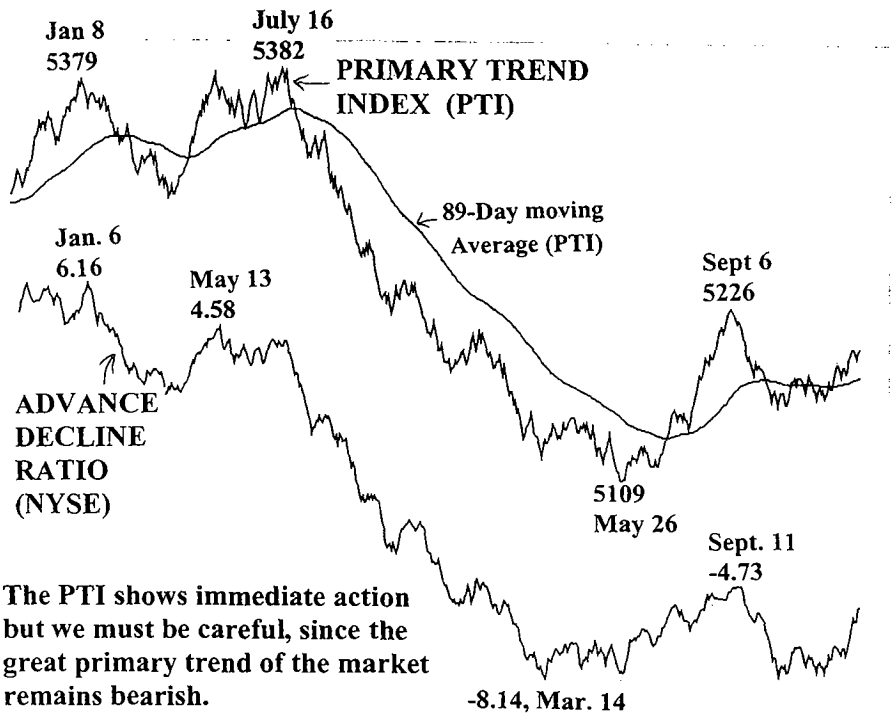
I'll be honest. I don't need this business as a means to a living any longer. I've sufficient assets so that I could retire tomorrow and my lifestyle wouldn't change. On top of that, my young, beautiful wife is a top corporate lawyer and partner in a law firm of over 1,000 lawyers, and the truth is that she now makes more money than I do – a lot more.

No, the reason I write *Dow Theory Letters* and the reason I write a daily Internet market report is that I want to – I love what I'm doing, and I love the fact that in my writing I am able to carry on the tradition of the Dow Theory. You know the old saying, "Love what you're doing, and you'll never work a day in your life." Lastly, I love the thought that (hopefully) I may be helping thousands of loyal subscribers to handle their money correctly according to Dow Theory principles.

A "double non-confirmation." First at "A" the Transports fail to confirm the new high in the Dow. Then at "B" the Dow fails to confirm the Transports. So first the Transports are weak, then the Dow is weak. This is a very rare and bearish pattern. It's the product of an overall weak market – a technically bearish market.



The "double non-confirmation" is a pattern you won't read about anywhere else. I discovered it years ago, and wrote about it in the early '70s.



The PTI shows immediate action but we must be careful, since the great primary trend of the market remains bearish.

I know that my job has never been simply to survive on a basic level or to learn how to make a living. Making a living has never been a problem for me. Putting three meals on the table has never been a problem for me.

But I can list eight different times when I could have, and probably should have, died or been killed. I honestly believe that there's some mysterious but meaningful reason why God has spared me.

One reason why I may have been spared is that I have two sets of children, the youngest only now a sophomore in college. My oldest "kids" now have children of their own. I firmly believe that one reason I have been spared is so that my youngest kids could have a father, even though their dad is, ahem, a rather over-aged father.

And well, to be honest, if I wasn't writing about the market (and various other items) I really wouldn't know what to do with myself. I don't play golf, I've stopped riding motorcycles, I don't gamble or play cards. I do garden (I'm a Cactus fancier) and I do have dogs, three standard poodles (arguably the most intelligent of all dogs).

I guess I grew up the hard way. I'm a child of the Great Depression and of combat during World War II. I also grew up quite neurotic and rather unhappy. Along the way I had a lot of help. I spent years in classical psychoanalysis (four days a week, for four years). I spent further years in Gestalt Therapy and more years in group therapy. I finally did what I set out to do, namely "I got my head on straight." It was the hardest thing I've ever done. But I learned, and in the course of learning I got happy. It took me half of my life to do it, but it was the best journey I've ever been on.

As one wise man put it, "Your most important duty on this earth is to find yourself and live accordingly." I've been trying to do that.

I believe that we are put on this earth for a reason. I believe perhaps 95% of the people on this earth are here on a survival basis, meaning that (in a good way) they are here to learn how to care for themselves and their children -- they are here to learn how to put three meals a day on the table and how to put a roof over their heads.

I believe that perhaps 5% of the people on this earth are here to be teachers. I believe that the teachers have already, somehow, learned the lessons of survival, they were born knowing how to survive.

I'm now 76 years of age, I'll be 77 next July. I've pondered why I'm still alive, still learning, and why God has seen fit for me to be writing to what I consider 7,000 exceptional people. Could I have been chosen as a teacher? That seems to be my reason for living. At least I feel as though it is. And I do feel that my subscribers (judging from correspondence received here over the years) are exceptional - well exceptionally bright. And they are good people.

In writing the above I don't want to sound arrogant or superior. I really don't think I am either. I'm simply writing the above because it's what I believe, and when you take the trouble to read a man's writings, it's always interesting to know what he thinks about himself, what his inner-most thoughts are, how he perceives himself in relation to the world.

I'm here to tell you what I think about the markets, and maybe through that to tell you how I think about myself and the world. I never started to write this way - it just evolved, or I should say I just evolved. I never really understood why I have spent 42 years writing about the market until recently.

Some people are of the opinion that a major bear market is God's way of smoting the arrogant, of battering the selfish, of teaching people that there are more things in life than just making money. A bear market might be considered God's retribution for our greed, our arrogance, our stupidity.

At any rate, we can all learn from bear markets, just as we have learned from the great bull market. Of course, it is also a source of satisfaction to be able to escape the ravages of the bear. And in my writings of the last year or so I've tried to help my subscribers to do just that – to escape the clutches of what could easily be a great, even an historic bear market.

Well, I've gotten all the above off my chest. Hope it helps to explain why I do what I do. I hope it also gives you some idea of why I write and maybe why you are reading *Dow Theory Letters*.

Next I want to repeat a lesson that is very hard to learn. There are no geniuses on Wall Street, only geniuses for a while. Watch the person who has been right for a long time. He or she is probably close to being wrong. Watch the (smart) person who has been wrong for a long while, he's probably close to being right.

There is only one expert on the market, and it's **the market itself.** The market contains everything we have to know about the future. Our task, the near-impossible task, is how to interpret correctly what the market is telling us.

In this business there are always the so-called "wise men" who tell us what the market will do next year or in coming years. I've learned to ignore them. I only listen to the market. The market knows more than any collection of Wall Street's leading so-called gurus. The market knows more than the Fed, the Treasury and all of Wall Street's gurus combined.

Recently we've received a dramatic lesson. And only the *New York Times* has exposed the disgraceful performance of most of Wall Street's analysts over recent years. In Sunday's *Times* (Dec. 31) headlined in the Business section we read, "How Did So Many Get It So Wrong?" The article starts, "Of all the rude awakenings that the bear market has brought to investors, perhaps the most jarring has been the realization of how woefully wrong Wall Street's research analysts have been this year on the stocks they follow. While the market sank in its worst performance in more than a decade, many of those analysts kept right on smiling and saying 'buy'.

"How can so many who are paid so much to scrutinize companies have blown it so spectacularly for their investor customers? The answer lies in a subtle but significant change in the way Wall Street analysts do their work – and how they are rewarded for it. That shift, which has bought riches and stardom to many securities analysts, has cost investors billions of dollars in losses. The fact is, although brokerage firm stock gurus are still called analysts, their day-to-day pursuits involve much less analysis and much more salesmanship than ever before."

What it amounts to is analysts writing up companies that are often sponsored by their bosses. "Today," writes the *Times*, "there is virtually no such thing as a sell recommendation from Wall Street analysts. Of the 8,000 recommendations made by analysts covering the companies in the S&P 500, only 29 now are sells, according to *Zacks Investment Research.*"

The article talks about Jack Grubman, who reportedly made $20 million at Salomon Smith Barney covering the telecommunications industry. "Investors who followed his picks have not done as well. Mr. Grubman began to advise caution on the 11 smallish telecom companies he covers in the so-called competitive local exchange carriers sector only two months ago after the stocks in the group had already lost 77% of their value. All 11 had securities underwritten by Salomon."

The article talks about Mary Meeker of Morgan Stanley who reportedly made $15 million last year. She's been a big bull on Internet stocks. "Now that Internet stocks are in pieces on the ground, she has become decidedly less vocal. In her reports she still rates all 11 Internet stocks she follows as 'outperform' even though as a group they are down an average of 83%. . . Of the 11 companies Ms. Meeker remains positive on, eight had securities underwritten by Morgan Stanley."

So Wall Street and its analysts have hit a new low, the lowest I've seen since I started writing these Letters 42 years ago.

Looking ahead. It was said that once the election was settled, the market would take off on the upside. I said that the smart people were buying on the rumor and that when the election was settled, the market would sell off. That's about what happened.

Now all we hear is that once the Fed begins to lower rates, the stock market will surge on the upside. That's the rumor. But I won't be shocked if the market sells off on the news of the first rate cut. After all, a number of rate cuts are already built into bonds and probably into stocks.

The Nasdaq has already gone through a severe bear market that has wiped out 53% of its value since the high. Stocks on the Nasdaq are still expensive, and I expect the Nasdaq to work lower in time.

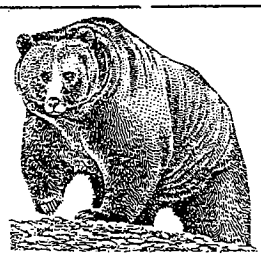
As I've stated so often, the public still relates to the Dow. Therefore, I'm most interested in the Dow's action from here on.

The first support, and it's strictly a psychological "support," is 1000 on the Dow. If the Dow breaks 10000, I believe investor sentiment will start to turn bearish (it certainly has remained bullish so far).

But the really critical Dow level is the 2000 low of 9796.03 recorded last March. In 18 years the Dow has not violated the low of a preceding year. This is why I believe 9796.03 is so important. If, in the year 2001, the Dow breaks below 9796.03 the Dow will have done something that it has not done in 18 years.

Thus, I would consider a Dow violation of 9796.03 the beginning of the real bear market in the Dow and in almost all stocks.

INVESTMENT POSITION: The bear stays in the box. So what do we do? Warren Buffett knows what to do. He continues to **compound,** but he does it with companies. Consider the following:



On June 20 Buffett bought Justin Industries for $600 million.
On Sept. 6 he bought Shaw Industries for $2 billion.
On Nov. 8 he bought Benjamin Moore Paints for $1 billion.
On Dec. 20 he bought Johns Mansville for $1.9 billion.

They're all businesses that are basic, but they all make money. And with the money these businesses make, Buffett will buy additional businesses.

I agree with Buffett. Compounding is the royal road to riches. Buffett isn't interested in glamour companies that make marvelous tech products. He's interested in companies that show profits and companies that throw off money.

I do the same thing with securities that I think are safe, and securities that throw off money. During the early part of 2000 I thought bonds and utilities fit the bill. I still think they do, but of course, they're a lot more expensive than they were in April or May.

NOTES & QUOTES: Those of you who hit my daily site know about my scare over prostate cancer, but subscribers who read only my Letter do not.

I had a prostate infection (most men at some time in their life will have this), and I had a PSA test at the same time. The PSA test was 8.4, which was above the accepted level for my age (my high should be around 4-5, the accepted level rises with your age).

My doctor put me on antibiotics and a few weeks later I had a second PSA. Instead of declining, my PSA rose to 9.7. A PSA above the accepted level or a rising PSA could be an indication of prostate cancer. My doctor, a urologist, said "Your PSA should be declining due to the antibiotics. Just in case I missed something (he did a digital test) I want to do a biopsy."

That, of course, set off my fear that I had cancer. As a matter of fact, almost all men at 80 years of age or over have traces of prostate cancer. At that age, however, it is usually slow growing, and the saying is that "you'll die with your prostate cancer but you won't die because of your prostate cancer. Nevertheless, there's something about cancer that is terrifying, and my case was no exception (even though I'm now 76).

At any rate, I told my subscribers on my site about it and asked them to pray for me. I said that I heard there is "power" in mass prayer. I received maybe over a couple of hundred great e-mails from subscribers. I took the biopsy (which is no fun), and three days later I got the result – "no trace of cancer."

I guess it all reminded me of something that happened on my third combat mission over the Brenner Pass in Italy during WW II. I remember this as though it was yesterday, I guess it was one of the defining moments of my life. There was flack from German 88s everywhere. Our plane was hit a few times, and it sounded as though somebody had hurled a barrel of gravel against the side of the plane. The B25 lurched with each hit.

I was bending over the Norden Bomb Sight. And I said to myself, "God, please get me out of this thing alive, and I'll never doubt again. And if I get out alive, I swear I'll never worry about anything again."

I did get out alive, and although I was an agnostic at the time, something within me changed. I had lived. Why had I lived? How could I have lived? I had heard the old expresson, "There are no athiests in foxholes." I believe it. When you're facing your own death which could come at any moment, I think it freezes something inside you. It's the ultimate in fear. I felt something of that same fear while waiting for the results of the biopsy.

Agnostic, athiest, it's easy to be one if you're safe and sound, maybe arguing with a friend over "whether there is a God." But when you're facing your own death at any moment, something else comes into the picture. Call it what you will, I know what I call it. Was it just fate or luck that saved me back in 1945 and this year and all eight times that I have faced death in the past? I don't think so, I really don't.

* *

There are more than 100 major mutual funds that have lost at least 40% of their value this year. On top of that, over 100 mutual funds this year have closed. According to The

Street.com, "Losses this year of 50% to 60% are now commonplace."

* *

On December 22, the D-J Utility Average rose to a new record high of 402.64. This is an amazing event. Even though I've recommended selected utility stocks all during the year 2000, I frankly never expected a new high on the Utility Average. And I'm not sure what it means.

Classically, the utilities tend to lead the stock market, often with a large lead time. I somehow doubt that that's what this new high means. What I do think it means is that it's the beginning, the "tip-off" to a new trend in the market. The new trend will be "towards safety and income." When I recommended selected utilities I said that not only was I recommending them, I was buying them for my family. The reason I was buying them was that at the time they were yielding at or above 6% in well covered dividends, and many of the utilities have long records of increasing their dividends. Furthermore, electricity and gas are not something consumers are going to turn down or turn off even during a recession or depression.

With thousands of mutual funds and pension funds now operating, I think we're seeing phenomena that we've never seen before. One is these mass movements in certain stock groups. And a sort of "lemming effect" where so many mutual fund managers rush to do the same thing – into tech stocks, out of tech stocks, into oil stocks, out of oil stocks, and into utilities. You even see it in the current movement into bonds.

The moves tend to be explosive and very emotional. It's not like the movements I saw in the stock market back in the '40s or '50s. In those days the markets were relatively quiet and steady, and stocks would move in eighths and quarters. You didn't see stocks jump 5, 10 and even 20 points in a day. Today never a day goes by when some stock or list of stocks are not up or down 5% to 15%.

This charge into utility stocks has been amazing. Does the new high in the utility stocks mean that the major averages will follow and go to new highs? I don't think it's that kind of a signal. I think it does mean, however, that we are going to see a trend towards safety and income. And when you're talking about safety and income, you're talking about two of the big winners of the year 2000 and of the bear market so far – utilities and high-grade bonds. These are the two groups that I've recommended to subscribers all year.

* *

We just got our third (and last) dog, another standard poodle. I now have a white female and two males, a black one and a little red male, which we have named Maximus or Max (after the hero of the movie, Gladiator). I've had Boston Bull Terriers, English Bull Terriers, Mastiffs, Great Danes, but knowing what I know now, I'd never have a dog other than a poodle. Poodles are arguably the most intelligent and trainable of all dogs, they don't shed (but they do need grooming), and they are listed as one of the ten best breeds for watch dogs. If anyone comes anywhere near our house, we know it and they know it. Standard poodles, I highly recommend them. And they are great around children.

* *

I've often said that if you want to make money in the stock market, you've got to be able to take a sizeable position in a stock group or in stocks in general or in some particular area. I often talk to investors who say, "I just bought 200 shares of Qualcomm." And I say to myself, "So what? What's that really going to do for you? If it goes up 20 points, you've got $4000 in paper profits before taxes. Then what? You're not really taking a position that will mean that much for you. Are you bullish or bearish on the market? Why just Qualcomm? Where's the rest of your money? Are you bullish or bearish on the market? If you're really bullish, is that all you're going to do?"

Example: When I turned bullish on bonds and utilities I put almost all our assets into the two. When bonds rose about 12% and I collected about 5.8% tax free on top of that (I bought munis) that meant that I had taken a worthwhile and meaningful position, not a willy-nilly purchase of a few hundred shares of stock.

But in order for me to take a large position, I always look at risk. What's my risk if the position turns out wrong? Would I sit with it or dump it? And if I dump my position, what are the consequences? **The consequences are crucial.** It's the crux of risk. What does it cost you if you are wrong and you have to bail out?

RISK and REWARD: I wrote about risk on one of my daily Internet sites recently, but since I have a few thousand subscribers who are not on the net, I want to write a bit more about risk.

For some reason, risk is one of the least discussed subjects in investing. Yet it is crucial for investors to understand and be aware of risk and the CONSEQUENCES of assuming a risk that doesn't work out.

The current stock market, by almost all historical measurements, is expensive. I've gone over the figures and measurements a hundred times. I've talked about the fact that the broad S&P sells for 25 times earnings and yields only 1.6%, the fact that the Dow has not broken below a previous year's low in 18 years, the fact that the Dow hasn't had a down year in a decade, about the thesis of regression to the mean. So let me put it succinctly, this market is **expensive,** and this market, on a longer-term basis, is virtually **uncorrected.**

Any way you look at it, this is a high risk market. If you believe otherwise, you're just kidding yourself (and I know that a lot of younger analysts do think differently).

When you buy stocks here you must consider the risk and the consequences of being wrong. What are the consequences of buying stocks in a high risk market?

Well, we're seeing one of the consequences in what I call the "Disaster du Jour." This is the collapse (and I mean COLLAPSE) of one, two or three stocks on a daily basis.

The list of disasters is long and growing, from MSFT to T, from PG to INTC. These are not just minor, unknown stocks, these are important, widely-held stocks.

Furthermore, we're not seeing insignificant losses in these stocks, we're seeing HUGE losses. For this reason, it's imperative that you consider the risk and consequences of buying stocks in a very expensive market.

Anytime you buy a stock (or anything else for that matter), you have to think of the **consequences if you are wrong.**

Examples: Your broker calls you and tells you that's he excited about a certain stock, and he thinks it's headed for "a double." He wants you to buy 500 shares for $75,000. Your entire net worth is $300,000. You think about it, but decide that the consequences of the stock not doing what your broker said it would -- are too risky. You're talking about risking 25% of your entire value on a single stock. You tell your broker that you'll pass.

The same broker calls your best friend with the same story. Your best friend is a multi-millionaire. He considers the risk and the consequences of the stock being a dog. Your friend ponders the siuation: he concludes that if the stock doesn't work out, he can sell it and, at worst, sustain a loss of $20,000. The consequences of a $20,000 loss won't hurt your friend, and he concludes that the speculation is worth a shot. He tells the broker, "OK, let's do it."

The same broker calls a third friend with the same offer. This friend cannot stand stress. He knows his own psyche, and he knows he's only at peace with stable, staid, dividend paying stocks. The consequences of buying the brokers prize stock would be a lot of stress, regardless of whether the stock went up or down. He tells the broker, "It sounds good, but it's not my kind of stock. I've got to sleep nights, but thanks anyway."

Conclusion: Risk, and the consequences of assuming risk, are critically important. In any purchase, whether a stock or a home or a car, consider the degree of risk, and the consequences if the risk turns out badly. I consider the consequences, no matter what I buy. And I don't think I've ever taken a loss that I couldn't handle with a minimum of stress.

LATE NOTES AND GOLD: First, gold: The action of gold is just plain discouraging here. After rising above its 50-day moving average during the end of November and much of December, gold (Feb. futures) sagged below its 50-day MA (the 50-day MA stands at 271.40) on January 2 and that's where it is now, below its 50-day MA.

The action just isn't good, and there's no way around it. I know that I have hundreds of subscribers who are firm believers in gold, but belief doesn't make a bull market – only price action does.

If gold is going anywhere, the first job of the active Feb. futures is to rally above 271.40. If that happens, it will be a lot easier for me to write bullishly about gold.

The break in the D-J Utility Average last week was huge. In three days the Utility Average broke through everything going back to last August, a drop of slightly more than 8%.

What does this mean? The Utility Average, historically, has been a lead indicator for the stock market (usually, but of course, not always). The Utilities are sensitive to interest rates, fuel prices and government regulations. The huge break in the Utility Average constitutes a negative for the stock market. But as I said, the "Utility barometer" has a long lead time.

The problem for utilities is acute. Many or even most of the utililties buy some of their electricity from wholesalers. The price of gas and electricity has surged sky-high, and the utilities have to pay it. But many of the utilities can only sell their product on a price-fixed basis. Thus, the big squeeze. Pacific Gas and Electric and SoCal Edison are on the verge of bankruptcy, paying high prices for fuel and selling their electricity and gas on a price-fixed basis.

It's a problem that's going to affect every corporation and family in the nation. And it better be solved soon. But how?

Market: This primary bear market started on May 12, 1999 – that was the last day that the Dow and the Transports hit **new highs together**. So the bear market is now almost two years old. In a bear market values deteriorate through time. And time is running out for the optimists and stockholders.

We're moving into the second (psychological) phase of the bear market. This is the phase where stocks go down as they discount deteriorating business conditions and declining corporate profits. Stocks are still very expensive. The S&P is selling at near 25 times earnings while yielding a pitiful 1.16%. These are bull market peak valuations. Yet bullish analysts continue to look for a "bottom."

The largest part of the bear market lies ahead. The operative words will be INCOME and SAFETY. Top-grade bonds fit the bill. That's the position I advocate. That's the position I am in.

NEXT MAILING: January 31, 2001